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U.S. INVESTMENT CLIMATE IN CHINA

Background

Since 1978, China has actively sought foreign investment. Austerity measures in 1988-89 and the political tensions following the 1989 Tiananmen incident led to a temporary deterioration of the environment for investment. However, with new calls for reform and opening following Deng Xiaoping's celebrated trip to South China in early 1992, a number of initiatives were launched to lure more foreign investment to China. The most significant of the reforms was the opening of new cities and sectors to foreign involvement. China became the "largest country in the world in terms of absorbing foreign investment in 1993," according to a World Bank report. In 1993, contracted foreign investment in China was US$ 110 billion and actual investment was US$ 25.7 billion, of which the U.S. accounted for $5.2 billion and $2.1 billion respectively.

Investment Laws and Incentives

China's legal and regulatory system is characterized by a general lack of transparency and inconsistency in enforcement. There are over 150 major laws and regulations which apply to foreign investment. Potential investment projects usually go through a multi-tiered screening process. The central government has delegated various levels of approval authority to local governments. Special Economic Zones (SEZs), 14 coastal cities, and provincial capitals, for instance, can approve projects valued at up to US$ 30 million. Projects exceeding these limits are approved by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and the State Planning Commission (SPC). If an investment involves US$ 100 million or more, it must obtain State Council approval.

China has a complex system of investment incentives which has been developed and broadened since the late seventies. The Special Economic Zones, 14 coastal cities, designated inland cities, provinces and even local governments all promote investment with unique packages of tax and other incentives. The Chinese authorities have also established special preferences for projects involving high-tech and export-oriented investments. Investment projects are evaluated by the government to see that they promote exports to increase foreign currency income, introduce advanced technology, or provide technical or managerial training. Priority sectors include transportation, communications, and energy. Since early 1992, access is being allowed on a very limited experimental basis in a number of previously forbidden sectors such as banking, retail, accounting, trade, real estate, tourism, and insurance.

Profit Repatriation

China encourages reinvestment of profits. Repatriation of profits from China can be difficult if they are not generated in foreign exchange. PRC regulations establish the general principle that foreign-invested projects must balance their foreign exchange receipts and expenditures. Few cases exist of Chinese authorities flatly refusing to release foreign exchange from the accounts of foreign-invested enterprises, but the procedures are lengthy and often require

extensive documentation. Despite the fact that the Chinese Government is setting up an interbank foreign exchange market for domestic enterprises, in the short term at least, foreign firms will be limited to buying and selling foreign exchange from each other on a modified version of the "swap market," which was first established in 1986.

Local Content

Chinese regulations grant foreign-funded enterprises freedom to source inputs both in China and abroad, but Chinese officials strongly encourage localization of production. Investment contracts often call for foreign investors to gradually increase the percentage of local content. When China joins the World Trade Organization, it will have to phase out local content rules in order to comply with Uruguay Round TRIMS provisions.

Protection of Intellectual Property Rights

Over the last ten years, China has enacted trademark, patent, and copyright legislation. Since the signing of a U.S.-China MOU on intellectual property in 1992, China has followed through on its commitments to joint international IPR conventions to enact or amend legislation. Serious problems remain, however, with China's enforcement of its IPR commitments. Book, CD, and computer software piracy, for example, remain widespread.

Investment Disputes and Expropriations

There have been no cases of expropriation of foreign investment since China opened to the outside in 1979, although the Embassy has intervened in the past to help solve several investment disputes. PRC authorities place strong emphasis on resolving disputes through informal conciliation and prefer, when necessary, arbitration through Chinese agencies. Litigation is regarded, reluctantly, as a final option. Many foreign investors have found the Chinese approach time-consuming and unreliable.

Technology Transfer

While China's investment laws and regulations do not require technology transfer, they strongly encourage it, and foreign investors are likely to encounter pressure to agree to it. Many joint ventures involve the transfer of technology either from the foreign partner as part of its capital contribution of under a licensing agreement, or from a third party.

OPIC

In the past, OPIC had a very active program in China. As of the end of 1990, 31 U.S. investments had OPIC political risk insurance. These projects represented an investment of approximately US$ 300 million in China. OPIC's program in China has been suspended since June 1989, however, first by executive action, and then by legislative sanctions that took effect in February 1990.

Bilateral Investment Treaty (BIT)

The United States and China held five difficult rounds of negotiations on a Bilateral Investment Treaty between 1982 and 1984. Many areas of disagreement were left outstanding at the end of these negotiations, including treatment, expropriation and dispute settlement. In February 1994, the TPSC agreed to use mechanisms other than the BIT to obtain meaningful investment policy commitments from China, but agreed that acceptance of these commitments could be a first step toward the evolution of a BIT. At present, investors in China must seek to obtain adequate guarantees, protections and stability of laws in their individual contracts. China has entered into bilateral investment agreements with 56 countries, including Japan and Canada.